



Zambia: open for business

Building due diligence solutions -
the investor view

General Report

March 2021



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Dear Colleague

Impact Capital Africa is delighted to be partnering with Prospero to deliver a series of virtual events over the course of 2021 entitled Zambia: Open for business.

After a difficult year for Zambian business and investment, we're working with leaders in the market to help power Zambia to recovery in 2021. These events are run on a small scale with hand-picked participants to facilitate a highly discursive session with actionable outcomes.

This first roundtable gathered senior executives from impact investors across Zambia, Africa and the rest of the world, to talk about the challenges in conducting due diligence under strict travel restrictions. Participants discussed how they can 'front load' the digital element of the process and then work with local partners for on-site verification and softer intelligence.

This report summarises the key discussion points and issues raised by the roundtable participants. Covering the shift in ticket sizes, changing relationships with growth businesses, and risk management strategies, it is the most comprehensive guide to remote due diligence in Zambia to date.

The final part of the report looks at the challenges investors face around locating and engaging reliable partners to perform local due diligence functions by proxy or to share insights into growth businesses.

One thing the discussion highlighted is the need for entities like ICA and Prospero to support investors by identifying and connecting them with verified, trusted partners. Communication, transparency, and trust are critical, and building relationships and rapport is still key.

With this in mind, we will explore with in-country partners and contacts about what we can do and come up with some tangible and practical ways that can support collaborations and alliances based on trust and transparency. If you have any thoughts, ideas or proposals that might be useful in this continuing work, please don't hesitate to get in touch with us.

We look forward to discussing potential solutions with you in future.

Kind regards,

Emma Parker
CEO, Impact Capital Africa



5 key take-aways: synthesising the main points

- 1 Less virtual, more hybrid**

Investors have had to react quickly to travel restrictions by developing virtual due diligence solutions. But during ‘in-person’ due diligence investors gain both hard and soft intelligence on their potential investee, some of which simply can’t be replicated remotely. A hybrid model, where investors conduct a portion of their diligence online and work with partners on the ground, is emerging as the most fitting solution.
- 2 It’s all about risk management**

Investors who are ready to invest in African growth businesses won’t be put off by a degree of perceived risk, but they are finding ways to adjust their investment process in order to mitigate as much pandemic risk as possible. We’re expecting to see ticket sizes increasing as investors address immediate cashflow issues, but equally this investment is likely to be spread over smaller tranches based on performance to offset the risk and build trust. This means more work up-front in structuring deals.
- 3 Contextual data**

It’s increasingly difficult to locate contextual data which offers meaningful insights into the current Zambian macroeconomic situation. Investors will need to work more closely with knowledgeable partners in the ecosystem who have insight into recent market developments, as previous assumptions and data may not still be relevant.
- 4 New ways of working**

Virtual due diligence is frustrating as it can be lengthy and cumbersome, and still doesn’t necessarily answer all the questions. However, some parties are increasingly working smarter to find shortcuts and partners who can help them deliver real insight in a more efficient way. As collaboration increases and is refined, expect to see the cost of due diligence coming down, and some long-term shifts in the way due diligence is conducted.
- 5 The era of collaboration**

Finding partners who can fulfil the in-country piece of a hybrid due diligence process and assist with pipeline access can make all the difference when it comes to getting deals done. Whether investors have strong networks in-country or not, a trusted source of vetted referrals for specialist support on the ground would make all the difference. ICA and Prospero may have a role here and will look to develop a practical approach.



How has COVID affected due diligence in Zambia?

- ▶ Investors agreed that COVID has taken a huge toll on physical due diligence and the ability to have feet on the ground in-country.
- ▶ Travel restrictions have resulted in a lengthening of timelines, both in terms of deal origination and due diligence itself. While traditionally the bulk of due diligence activity took place on-site over a few days of intense work, now multiple, shorter, remote interactions seem to have the effect of reducing the sense of urgency, as investors raised that SMEs can be slow to respond to requests for information.
- ▶ As well as issues around physical meetings and site visits, the ability to measure risk and agree valuations was flagged as a significant issue in completing the due diligence process. Uncertainty abounds, so projections for growth on both a market and company scale can no longer be confidently built solely from historic data.
- ▶ Investors are having to adapt their processes and ask more of businesses in both historical performance, COVID performance, and detailed, clear, COVID-based growth planning. This in turn is affecting investor confidence and valuations.
- ▶ Investors pointed out that finding reliable sources of hard intelligence about economics and market trends in Zambia is not as straightforward as locating this data in 'larger' and more established markets. Given the current pandemic circumstances, data which is two or three years old can give a very different picture to what's happening on the ground.
- ▶ There is also an increasing mis-match between how investors and business owners assess risk and value their businesses. Business owners are keen to tell a growth story and rely on historical performance metrics to do so. For investors, whose focus is on the future, operational and market risk, it is short term cashflow and the impact of COVID on supply chains that take precedence.

'The assessment of market risk is key for us. Our usual method of assessing short- and long-term business prospects, cashflow and investment need is increasingly hard to contextualise.'

- Impact investor



What solutions have worked so far?

- ▶ Most investors who have closed deals in Zambia over the last year have relied upon two main sources of intelligence for their due diligence: digital communication and on-the-ground partners.
- ▶ While digital communication can replicate some elements of the due diligence process adequately, a trustworthy partner who can deliver local insight and on-site verification is essential for investors who aren't in country. The main challenge here is in finding the right partner: it isn't easy to find someone who will understand your goals and whose judgement you trust.
- ▶ The challenges to the due diligence process that have arisen since the outbreak of COVID are not without some potential benefits. They have encouraged investors to ask searching questions about the purpose of the process, and to identify the information required that is truly mission-critical. In turn, this has made it clearer where there is a targeted requirement for on-the-ground support from reliable local partners.
- ▶ Another key strategy which has supported due diligence to date is that of collaboration between investors. Naturally, SMEs who have already undergone the due diligence process as part of an earlier round of fundraising are a significantly de-risked option compared to entirely new investments.
- ▶ Relying on previous due diligence carried out by co-investors is useful but it can also be limiting. And if co-investors are not including Zambia in their portfolio, this is an issue.
- ▶ Participants in the roundtable agreed that sharing intelligence from completed due diligence or KYC assessments would be the quickest and easiest way to fast track remote due diligence where it existed. The idea of 'open source' due diligence, where intelligence from a number of parties is shared and can be re-purposed for individual needs, could prove highly effective under current circumstances, but would require agreement from businesses under consideration, as this information is sensitive.
- ▶ Because of higher levels of uncertainty, some investors are breaking investments into smaller tranches, helping to build confidence over time.
- ▶ This 'hybrid' approach to due diligence, combining in-house expertise with outsourced knowledge and collaborative intelligence, could revolutionise the due diligence process and significantly reduce cost, but only if the right balance between each of these elements is found.

'[The current situation] makes investors think in a much more targeted way about the outcomes they want to achieve from the due diligence process: what core information is critical to enable an investment to move forward, then local support partners can supplement the work already completed. Finding vetted, trustworthy local partners whose judgement you can rely on is one of the biggest challenges for international investors in these circumstances.'

- Financial and investment adviser



A catalyst for change?

- ▶ Due diligence has always been a significant cost within the investment origination process. Time taken for senior team members or expensive consultants to visit sites and offices, digging up data and assessing financials, has created a cost structure that has made investments in smaller businesses in smaller markets economically unattractive.
- ▶ Our participants discussed the fact that COVID may provide a watershed moment for due diligence – helping to create changes in processes and lasting partnerships which can reduce cost through remote access and knowledge sharing. Lower due diligence costs present a valuable upside which can help to balance the higher risk, but in the future a more streamlined and cost-effective process may allow investors to review downwards the lower threshold for ticket sizes that are worthwhile for consideration or to enter new markets.
- ▶ Although travel restrictions impacted deal flow in 2020, most investors now expect to be able to achieve their target numbers through virtual and partner due diligence.
- ▶ Previously due diligence presented a binary choice for investors: use management time to complete or outsource the whole lot to senior level consultants. Now investors can build toolkit of solutions which can help them to achieve their goals in a more creative and cost-efficient way.
- ▶ From using existing networks to finding specialist providers, working with a local proxy partner is likely to become ingrained as a key element of the due diligence process even as restrictions lift. Equally, the value of collaboration between investors or key market players can cut duplicated effort and give a due diligence process a running start.
- ▶ Layering these solutions over a re-focussed virtual due diligence, and recognising what information you really need to gather yourself and what you can entrust to partners will open up new opportunities for investment in Zambia.

‘Working with co-investors and being able to access due diligence that has already been completed has been really useful. But it is also kind of limiting. There’s a lot of opportunities we’ve been missing as we’ve been a little bit ‘safe’. Maybe [we should look to] build our network of experts on the ground and advisers who can better direct us to pipeline and deal flow without us having worked directly with the founder themselves’.

- International impact investor



What next?

- ▶ There is momentum in Zambia (and across Africa) to facilitate remote or hybrid due diligence and accelerate the deals being done in the country. Those markets which can support investors as they struggle to travel will reap the benefits of capital deployment and help them to develop networks which can power further investment into the country as things begin to ease.
- ▶ The main challenge to the due diligence process is locating the right mix of trusted partners in a relatively cost effective and easy way.
- ▶ From the discussions had at the ICA and Prospero roundtable, Zambia already boasts a great number of resources in the form of local investors, international investors, donors, NGOs, local banks, market experts and well-respected consultants.
- ▶ A Zambian commercial bank that participated in the discussion suggested that it could potential collaborate as it completes regular assessments of clients under their KYC obligations and holds insight into many Zambian businesses. The ability to tap into this resource could be an important tool for streamlining a hybrid due diligence solution. This bank also reports turning away good companies looking for “decent deals” simply because the bank does not handle those particular types of longer duration instruments. This opens up pipeline collaboration opportunities.
- ▶ Another source of pipeline, contextual information and due diligence support could be organisations that work with impact-rich businesses seeking project grant support, often alongside commercial finance.
- ▶ **Investors agreed that building a network of accredited or vouched-for partners who could support remote due diligence would be immensely valuable. Whether they already have a network in country or they are just building one, the ability to choose partners due to specialism or connections would help to speed up due diligence and help to build trust in the process.**

‘[Regarding companies screened for project grant support] in terms of our due diligence process, we would be happy to potentially share that information with investors who were interested in these particular projects. Our framework looks at 14 different areas from the leadership piece down to the whole way the company is looking at its strategy’.

- Development NGO



A “community of practice”? What could this look like?

- ▶ Our conclusion is that there is a role for facilitating increased collaboration between various members of the ecosystem for both due diligence and project origination.
 - ▶ This could take several forms, perhaps in the form of a directory or ‘little black book’ of contacts in the market, or a platform provided by neutral facilitators such as Prospero or Impact Capital Africa.
 - ▶ We’re keen to further the conversation and dig into how we can catalyse the key players in the market to take the next steps in this process.
 - ▶ **To this end we will explore with in-country partners and contacts about what can be done to come up with some tangibles.**
 - ▶ In the meantime, please do come back to us with any thoughts, comments or requests so that we can feed them into the mix.
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- ▶ In our next event, an SME roundtable, we will pose parallel questions around remote due diligence to businesses currently seeking finance and those that have gone or are going through a remote due diligence process. We aim to capture not only their experiences, but their response to the investor insights noted in this report, and to use this to build a response plan.
 - ▶ **As always, ICA and Prospero’s aim is to maintain and promote Zambia as a viable and attractive investment destination through targeted risk mitigation. We’ve seen that the investors in our ever-growing network are still eager to find opportunities despite the risks and challenges.**

‘If we were to look at ways to create a community of practice around the Zambian investment ecosystem, building on our networks but with more collaboration and discussion between domestic, regional and international investors, advisers and other parties on the ground, would you be interested?’

- Emma Parker, Impact Capital Africa

‘Yes, times a thousand’

- Impact investor





Can the ICA team help you?

Speak to us for details about
consultancy services, partnerships
and sponsorship opportunities

Contact emma@impactcapafrica.com

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